BANK POLICY INSTITUTE

August 29, 2022

Via Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551
Attn: Ann E. Misback, Secretary

Re: Regulation Implementing the Adjustable Interest Rate (LIBOR) Act (Docket No. R–1775; RIN 7100–AG34)

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Federal Reserve's notice of proposed rulemaking to implement the Adjustable Interest Rate (LIBOR) Act (the "*Act*").[2] We support the Federal Reserve's proposal to adopt this regulation, which would implement the Act and carry out Congress's goal of creating a uniform, nationwide approach for replacing USD LIBOR in so-called "tough legacy contracts."[3] In this letter, we offer a number of recommendations intended to promote the objectives of the Act and the Federal Reserve's proposal and to clarify certain ambiguities.

Part I of this letter explains why the Federal Reserve should eliminate the definitions of and framework contrasting "covered contracts" and "non-covered contracts." Part II requests a clarification regarding the application of the Act and proposal to derivatives with reset dates on July 3 or July 4, 2023. Part III responds to the Federal Reserve's request for feedback on the "potential ambiguity" identified in the proposal relating to LIBOR contracts with fallbacks that are triggered only when USD

1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 Federal Reserve, *Regulation Implementing the Adjustable Interest Rate (LIBOR) Act*, 87 Fed. Reg. 45268 (July 28, 2022).

3 "Tough legacy contracts" are contracts that reference USD LIBOR and will not mature by June 30, 2023, but which lack adequate fallback provisions providing for a clearly defined or practicable replacement benchmark following the cessation of USD LIBOR. *See id.* at 45269.

LIBOR is "unavailable." Part IV addresses benchmark replacement conforming changes for consumer loans and other LIBOR contracts. Part V responds to certain of the specific questions the Federal Reserve presents in the proposal.

I. The Federal Reserve Should Eliminate the Definitions of and Framework Contrasting "Covered Contracts" and "Non-Covered Contracts."

The proposed regulation would generally treat LIBOR contracts that do not provide for the use of a clearly defined or practicable benchmark as "covered contracts." Other LIBOR contracts, including LIBOR contracts that identify a specific benchmark replacement or a determining person who has selected a benchmark replacement, would be "non-covered contracts." Under the proposed regulation, the applicable Board-selected benchmark replacement would become the benchmark replacement for covered contracts on the LIBOR replacement date, but the proposed regulation states that it generally would not affect a non-covered contract.

The Federal Reserve should eliminate the concepts of "covered contracts" and "non-covered contracts" because the defined terms do not align with the scope of application of the Act and the defined terms introduce ambiguity. The proposed definition of "covered contracts" in Section 253.3(a)(2) would generally track Sections 104(a), 104(b) and 104(c)(2)-(3) of the Act. The defined term (and therefore the proposed regulation) would, however, appear to not be co-extensive with the scope of application of the Act. For example, there could be LIBOR contracts in respect of which the Board-selected benchmark replacement would become the benchmark replacement by operation of law pursuant to the Act (an "*Act-affected contract*"), but that would not be "covered contracts" under the proposed regulation. Likewise, there could be contracts that would be "covered contracts" under the proposed regulation but that would not be Act-affected contracts. This gap between the proposed regulation and the Act arises because (i) the defined term "covered contracts" would not reflect the rules of construction in Section 104(f) of the Act and (ii) the definition of "covered contracts" varies in some ways from the corresponding statutory language of the Act.[4]

Moreover, proposed Section 253.3(b)(1) introduces ambiguity and is inconsistent with the Act. That Section states that the regulation would not affect LIBOR contracts that are not covered contracts (that statement is subject to an exception in Section 253.3(b)(2)). There are, however, LIBOR contracts that (i) would be "non-covered contracts" under the proposal, and (ii) would be affected by other provisions in the regulation. For example, Section 253.5(a)(2) would apply to benchmark replacement conforming changes by a calculating person for a LIBOR contract that is not a consumer loan, whether a "covered contract," or a "non-covered contract," such as a LIBOR contract under which the determining person has selected the Board-selected benchmark replacement.

If the Federal Reserve does, however, decide to retain the definitions of "covered contracts" and "non-covered contracts," we recommend that the Federal Reserve address three inconsistencies and ambiguities arising out of those definitions and the framework based on those terms.

First, the Federal Reserve should clarify and confirm that the statutory protections, including the safe harbor, in Section 105 of the Act would apply to a non-covered contract for which a determining

4 Section III discusses an example of language in the proposed regulation that differs from the language in the corresponding provision of the Act, and explains why that drafting difference introduces ambiguity with respect to the application of the proposed regulation.

person has selected the Board-selected benchmark replacement. The statutory protections generally apply to, among other things, the "selection or use of a Board-selected benchmark replacement,"[5] including the selection by a determining person. In the proposal, the Federal Reserve explains that it views certain provisions of the Act, including the statutory protections in Section 105, as "self-executing."[6] Consistent with this view, the proposed regulation would not include provisions addressing or implementing Section 105.

As relevant here, proposed Section 253.3(b) would address the ability of a determining person to select the Board-selected benchmark replacement and otherwise provide that the regulation "does not affect LIBOR contracts that are not covered contracts." The provision providing that the regulation would not "affect" non-covered contracts, together with the description of the regulation as "implementing" the Act, introduces potential ambiguity with respect to the application of the statutory protections, including the safe harbor, to non-covered contracts for which a determining person has selected the Board-selected benchmark replacement. The potential ambiguity arises because the fact that the proposed regulation implementing the Act states that it would not "affect" a non-covered contract could potentially imply that the Act itself does not affect a non-covered contract. There are, however, aspects of the Act that would "affect" non-covered contracts, including the statutory protections in Section 105. Accordingly, the Federal Reserve should clarify and confirm the application of those protections to a non-covered contract for which a determining person has selected the Board-selected benchmark replacement.

Second, the Federal Reserve should revise proposed Section 253.3(b) to make clear that Section 253.5(a)(2) would apply to a non-covered contract for which a determining person has selected the Board-selected benchmark replacement. As noted above, Section 253.3(b) would provide that the regulation would not "affect" LIBOR contracts that are not covered contracts other than as stated in Section 253.3(b)(2). Consistent with Section 103(4)(B) and Section 104(d) of the Act, Section 253.5(a)(2) of the proposal would address the ability of a calculating person to make benchmark replacement conforming changes with respect to a LIBOR contract that is not a consumer loan. Sections 103(4)(B) and 104(d) of the Act, like proposed Section 253.5(a)(2), would apply generally to LIBOR contracts that are not consumer loans, including LIBOR contracts that would be "covered contracts" under the proposed regulation and those that would be "non-covered contracts" under the proposed regulation if the determining person has selected the Board-selected benchmark replacement. Accordingly, the Federal Reserve should revise Section 253.3(b) to make clear that Section 253.5(a)(2) would apply to a non-covered contract under which a determining person has selected the Board-selected benchmark replacement. This revision and clarification would reflect that there are certain aspects of the proposed regulation in addition to Section 253.3(b)(2) that would apply to non-covered contracts.[7]

Third, the Federal Reserve should clarify the treatment of a LIBOR contract that both identifies a specific benchmark replacement and a determining person. There are certain LIBOR contracts that

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5 *See, e.g.,* Sections 105(a), 105(b) and 105(c)(1) of the Act.

6 *See* 87 Fed. Reg. at 45271, n. 35.

7 As a related conforming change, the Federal Reserve should also revise the first clause of proposed Section 253.1(c) to refer to Section 253.5(a)(2). As explained above, the regulation would apply to non-covered contracts that are not consumer loans in connection with a calculation agent's making benchmark replacement conforming changes pursuant to Section 253.5(a)(2) following a determining person's selection of the Board-selected benchmark replacement.

provide that, upon a trigger event, (i) a specific non-LIBOR benchmark will apply instead of LIBOR and (ii) a determining person could, but is not required to, select an alternative benchmark replacement instead of the identified replacement. The Act has a specific provision that addresses the treatment of these LIBOR contracts: per Section 104(f)(2) of the Act, these contracts would not be altered or impaired by the Act and would instead operate in accordance with their terms, which could include the application of synthetic LIBOR (for example, if fallback is triggered only if LIBOR is "unavailable"). The treatment under the proposed regulation is, however, not clear. There are provisions of the proposed regulation providing that a LIBOR contract that identifies a specific benchmark replacement would not be a covered contract. Per these provisions, the LIBOR contracts described above would not be covered contracts. Rather, they would operate according to their existing terms and, upon the trigger event (and assuming the determining person does not select an alternative benchmark replacement) transition to the specifically identified non-LIBOR based benchmark. There are, however, other provisions of the proposed regulation generally providing that a LIBOR contract would be a covered contract if the contract identifies a determining person and the determining person does not select a benchmark replacement by the earlier of the LIBOR replacement date and the latest date for selecting a benchmark replacement according to the terms of the LIBOR contract. Per these provisions, the LIBOR contracts described above could potentially be viewed as covered contracts if the determining person does not select a benchmark replacement date by the applicable deadline. Because the definition of "covered contracts" does not reflect the rules of construction in Section 104(f) of the Act, the "covered contracts" vs. "non-covered contracts" framework introduces ambiguity and a potential inconsistency with the Act.

Accordingly, if the Federal Reserve retains the "covered contracts" and "non-covered contracts" definitions in the final rule, the Federal Reserve should clarify and confirm that the LIBOR contracts described above (those that both identify a specific non-LIBOR benchmark replacement and a determining person) would not be covered contracts, irrespective of whether the determining person has selected a benchmark replacement. This clarification would be consistent with Section 104(f) of the Act, as well as the commentary in the proposal that a LIBOR contract would be a non-covered contract if, on the LIBOR replacement date and after giving effect to aspects of the Act and proposal that would make certain fallback provisions null and void, "(i) the LIBOR contract has fallback provisions that identify a specific benchmark replacement, (ii) the LIBOR contract identifies a determining person that has selected a benchmark replacement, ***or*** (iii) the parties to the contract have agreed in writing that the contract shall not be subject to the LIBOR Act."[8] So long as one of (i), (ii) or (iii) is applicable, the LIBOR contract should not be a covered contract.

II. The Federal Reserve Should Clarify the Application of the Act to Derivatives with Reset Dates on July 3 or July 4, 2023.

The Federal Reserve should clarify that, for reset dates in derivatives that are covered contracts occurring on or after July 3, 2023, the implementation of the Board-selected benchmark replacement would be consistent with the operation of the ISDA protocol. (July 3, 2023 is anticipated to be the LIBOR replacement date, as the anticipated first London banking day after June 30, 2023.) The proposed regulation would specify that, for derivative contracts, the "Fallback Rate (SOFR)" in the ISDA protocol would be the benchmark replacement as of the LIBOR replacement date. Under the ISDA protocol, the specified fallback rate will apply upon a reset date occurring two or more London banking days after July 3, 2023, which is the "Index Cessation Effective Date" under the ISDA protocol.

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[8] 87 Fed. Reg. at 45272 (emphasis added).

Typically, a derivative would specify that a reset date is two London Banking Days after the applicable USD LIBOR determination date. Under this framework, a derivative with a reset date on July 3 or July 4, 2023 (fewer than two London banking days after July 3, 2023) will have a determination date prior to July 3, 2023. For a such a contract, the benchmark under the ISDA protocol for the July 3 or July 4, 2023 reset date will be USD LIBOR because the related determination date will be on June 29 or 30, 2023.

The Federal Reserve indicates that the proposed regulation would operate in a similar fashion. Proposed Section 253.4(b) would provide that the selection and use of the Board-selected benchmark replacement would not affect the dates as of which contractual rates are determined. The Federal Reserve also provides an example with respect to a cash product, noting that if the benchmark is determined as of a specified date that precedes the LIBOR replacement date, the USD LIBOR benchmark originally specified in the contract would be used, including for reset dates occurring after the LIBOR replacement date.[9] The Federal Reserve should confirm that this framework would apply to derivatives as well and also provide an example with respect to derivatives. Clarification and an example would make clear that the implementation of the Board-selected benchmark replacement for derivatives would be consistent with the implementation of the benchmark replacement under the ISDA protocol.

III. The Federal Reserve Should Clarify the Application of the Act and Proposed Regulation to Covered Contracts with Fallbacks that are Triggered Only when USD LIBOR is "Unavailable."

The Federal Reserve identifies a potential ambiguity due to the possible publication of synthetic LIBOR[10] for a subset of LIBOR contracts with fallback provisions that either (i) identify a clear and practicable benchmark replacement or (ii) authorize a determining person to select a benchmark replacement, but that apply only when LIBOR is "unavailable" rather than "nonrepresentative."[11] The Federal Reserve also seeks feedback on whether the final rule should provide that the benchmark replacement specified pursuant to a non-covered contract would replace references to LIBOR in that contract on the earlier of the date specified pursuant to the LIBOR contract or the LIBOR replacement date.[12]

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9 *See id.* at 45276 ("[I]f a covered contract that is a cash transaction originally indicated that a 12-month LIBOR rate would be determined using the value as of a prior date (e.g., 45 days prior to the payment date), then following the LIBOR replacement date, the corresponding Board-selected benchmark replacement rate (12-month CME Term SOFR) also would be determined using that benchmark replacement's value as of the specified prior date. To the extent that the specified prior date precedes the LIBOR replacement date, the benchmark originally specified in the contract—here, 12-month LIBOR—would be used, consistent with the covered contract's terms. However, once the parties would look to a benchmark value as of a date on or after the LIBOR replacement date under the covered contract's terms, the corresponding Board-selected benchmark replacement—here, 12-month CME Term SOFR—would be used.")

10 The FCA has announced that it will compel the LIBOR administrator to continue to publish 1-, 3- and 6-month sterling LIBOR tenors on a "synthetic" basis. It has requested information regarding whether it should do the same for USD LIBOR tenors. *See* FCA, CP22/11: Winding down "synthetic" sterling LIBOR and USD LIBOR, available at https://www.fca.org.uk/publications/consultation-papers/cp22-11-winding-down-synthetic-libor-us-dollar-libor.

11 *See* 87 Fed. Reg. at 45272.

12 *See id.* at 45273.

With respect to contracts described in clause (i) above and as also discussed above in Section I (*i.e.*, contracts that identify a clear and practicable benchmark replacement), we recommend that the Federal Reserve not address these contracts in the final rule. As the Federal Reserve notes, the LIBOR Act does not expressly address the treatment of these contracts in the context of the publication of synthetic LIBOR on and after the LIBOR replacement date, and the Act generally provides that contracts that identify a clear and practicable benchmark replacement are unaffected by the Act.[13]

With respect to contracts described in clause (ii) above (*i.e.*, contracts that authorize a determining person to select a benchmark replacement),[14] the Federal Reserve should revise the final rule to make clear that those contracts would be covered contracts if the determining person has not selected a benchmark replacement by the earlier of the LIBOR replacement date and the latest date for selecting the benchmark replacement according to the terms of the LIBOR contract.

Section 104(c)(3) of the Act provides that "if a determining person does not select a benchmark replacement by the date specified in paragraph [104(c)(2)(B) of the Act, *i.e.*, the earlier of the LIBOR replacement date and the latest date for selecting the benchmark replacement according to the terms of the LIBOR contract]," then "the Board-selected benchmark replacement, on and after the LIBOR replacement date, shall be the benchmark replacement for the LIBOR contract." Under contracts with fallbacks trigged only when LIBOR is "unavailable," if (i) synthetic LIBOR is published on and after the LIBOR replacement and (ii) the determining person does not select a benchmark replacement by the LIBOR replacement date for any reason (whether because the requirements for its authority to select a benchmark replacement have not been met, or otherwise), then, under the plain language of Section 104(c)(3), the Board-selected benchmark replacement would become the benchmark replacement for the contract on and after the LIBOR replacement date. Section 104(c)(3) only takes into account whether a determining person has made a selection, or not. The reason a determining person has not selected a benchmark replacement is not relevant to the application of Section 104(c)(3).

There are various aspects of the proposal consistent with this interpretation and application of Section 104(c)(3) of the Act.

- In footnote 21 and the accompanying text, the Federal Reserve notes that the potential publication of synthetic LIBOR on and after the LIBOR replacement date could create ambiguity regarding the application of the Act to certain LIBOR contracts that contain fallback provisions identifying a specific benchmark replacement not based on LIBOR. Notably, the Federal Reserve does not reference the potential ambiguity in the context of the discussion that follows on the same page regarding LIBOR contracts that contain fallback provisions authorizing a determining person to select a benchmark replacement.[15]

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13 *See, e.g.*, Section 104(f)(2) of the Act ("(f) Nothing in [the Act] may be construed to alter or impair—(2) except as provided in subsection (b), any LIBOR contract that contains fallback provisions that identify a benchmark replacement that is not based in any way on any LIBOR value (including the prime rate or the effective Federal funds rate);").

14 These contracts would not identify a specific benchmark replacement and, accordingly, would differ from the contracts discussed on pages 3 to 4 that both identify a specific benchmark replacement and authorize a determining person to select a different benchmark.

15 *See* 87 Fed. Reg. at 45270.

- In the discussion of the definitions of the terms “covered contract” and “non-covered contract,” consistent with the plain language of Section 104 of the Act, the Federal Reserve explains that a contract for which a determining person has not selected a benchmark replacement by the LIBOR replacement date would be a “covered contract,” and one for which a determining person has timely selected a benchmark replacement would be a “non-covered contract.” The reason a determining person does not select a benchmark replacement is not presented as a relevant factor.[16]

In order to clarify that contracts that authorize a determining person to select a benchmark replacement only when LIBOR is “unavailable” would transition to the Board-selected benchmark replacement on the LIBOR replacement date in the event synthetic LIBOR is published on and after that date and a determining person does not select a benchmark replacement by the time specified in Section 104(c)(2)(B) of the Act, the Federal Reserve should:

- Replace the words “has failed to select” with “has not selected” in proposed Section 253.3(a)(2)(i)(C). As noted above, Section 104(c) of the Act focuses on whether a determining person does or does not select a benchmark replacement by the date specified in Section 104(c)(2)(B) of the Act. Replacing the words “has failed to select” with “has not selected” would conform the text in the regulation to the statutory language. This change would also reduce the potential for ambiguity relating to the application of Section 253.3(a)(2)(i)(C) to contracts that have only an “unavailable” trigger. For contracts that contain only an “unavailable” trigger, a determining person could potentially be seen as not having “failed” to do anything if the trigger event for the determining person to act is viewed as not having occurred by the date specified in Section 104(c)(2)(B) of the Act. The words “have not selected” would make the proposed regulation both more objective and more consistent with the statutory text.[17]

- Revise Section 253.3(a)(2)(i)(C) to expressly state that the provision would apply to a contract in respect of which a determining person has not made a selection for any reason, including because the trigger event for the determining person to do so has not occurred by the LIBOR replacement date.

- Revise Section 253.1(c) so the general scoping provision of the regulation would refer to Section 253.3(a)(2)(i)(C). This change would clarify that the regulation would apply to and affect a LIBOR contract with a determining person that does not make a timely selection of a benchmark replacement (for whatever reason) because such a contract would be treated as a covered contract.[18]

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16 *See id.* at 45272.

17 This revision and the revision in the next bullet point would not be necessary if, as recommended in Section I, the Federal Reserve eliminates the definitions of “covered contracts” and “non-covered contracts” and the framework contrasting one from the other in the final rule.

18 Separate from the recommendations in this section, the Federal Reserve should also revise Section 253.1(c) to clarify that there are aspects of the regulation, such as proposed Sections 253.5(a)(2) and 253.6, that would apply to LIBOR contracts under which a determining person selects the Board-selected benchmark replacement.

IV. The Federal Reserve Should Clarify Certain Benchmark Replacement Conforming Changes.

Many consumer loans refer to LIBOR as an index published in the Wall Street Journal or another specified source. Under the proposal, the Board-selected benchmark replacements for consumer loans would be deemed to be the specified rates published by Refinitiv. These rates are not anticipated to be published in the Wall Street Journal or other sources currently referenced in LIBOR contracts that are consumer loans. The Federal Reserve should clarify that a calculating person could use the rates published on the relevant Refinitiv pages and need not source the benchmark replacement from the Wall Street Journal or other specified source in the relevant LIBOR contract. This clarification is important because, under the Act, only the Federal Reserve can make benchmark replacement conforming changes with respect to consumer loans.

Certain consumer loans that would be covered contracts under the proposal use the average of 1-month LIBOR over the previous 12-month period. Under the proposal, the Board-selected benchmark replacement would be used on and after July 3, 2023 for these consumer loans. In light of the guidance quoted in footnote 9 above, it appears that the calculating person would have to bifurcate the calculation of this average, using LIBOR through June 30, 2023 and the Board-selected benchmark replacement on and after July 3, 2023. The Federal Reserve should clarify how averages over a period that spans the LIBOR replacement date should be calculated and, to the extent the calculation involves any benchmark replacement conforming changes, specify those benchmark replacement conforming changes in the regulation because only the Federal Reserve can make benchmark replacement conforming changes for consumer loans.

Many LIBOR contracts refer to LIBOR, as published on a specified screen, typically as of 11:00 A.M. London time on the relevant determination date. The proposed rule would provide that the determination date for any Federal Reserve-selected benchmark replacement would be the same day that would have been used to determine the LIBOR-based rate (or the most recently available publication if the Board-selected benchmark replacement is not published on that date). The Federal Reserve should clarify that the standard publication time for the Board-selected benchmark replacement would supersede any references to 11:00 A.M. London time (or any other particular time) for determining LIBOR by reference to a screen or other source. This clarification would avoid the possibility of using a benchmark replacement as of an earlier date than the specified determination date if, due to time zone differences or changes in publication times, the Board-selected benchmark replacement is published on a given date later than 11:00 A.M. London time (or any other particular time specified in a LIBOR contract).

V. Other Matters.

The Federal Reserve asks whether it should consider requiring a determining person to provide notice to one or more parties concerning the selection of a benchmark replacement and, if so, what specific notification requirements would be appropriate and why.[19] The Federal Reserve should not prescribe timing or any other requirements for advance notice. Determining persons should have flexibility to provide notice when and as it determines is appropriate, and imposing a prescriptive advance notice requirement in addition to any notice requirements established in the contracts themselves could impose undue operational burdens and inadvertently hamper transition efforts. The imposition of prescriptive advance notice requirements could also result in duplicative or inconsistent

[19] *See* 87 Fed. Reg. at 45277.

requirements as the Act does not override and otherwise address notice requirements that may be set forth in existing contracts or apply under other laws or regulations.

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BPI appreciates the opportunity to comment on the Federal Reserve's proposal. If you have any questions, please contact the undersigned by phone at or by email at Brett.Waxman@bpi.com.

Respectfully submitted,

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Board of Governors of the Federal Reserve System